

Message Text

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C O N F I D E N T I A L LISBON 2030

DEPT. PASS TREASURY FOR SYVRUD

E.O. 11652: XGDS-3
TAGS: EFIN, ECON, PO
SUBJECT: PORTUGUESE/IMF NEGOTIATIONS

REFS: A) LISBON 1861 B) LISBON 1965

SUMMARY. AFTER SOME INITIAL HESITATION, FUND HAS AGREED TO RESUME FORMAL NEGOTIATIONS WITH GOP ON MARCH 29. MOST DIFFICULT ISSUE CONTINUES TO BE INTEREST RATE POLICY. COMPROMISE ON CREDIT CEILINGS AND EXCHANGE POLICY APPEARS TO BE FALLING INTO PLACE. GOP ACCEPTS NECESSITY FOR RAPID AGREEMENT. END SUMMARY.

1. FINANCE MINISTER CONSTANCIO CALLED US FRIDAY EVENING, MARCH 17, TO EXPRESS HIS GREAT CONCERN ABOUT APPARENT FUND UNWILLINGNESS TO RESUME NEGOTIATIONS IMMEDIATELY. FUND RESPONSE TO HIS INVITATION (REF B) TO REINITIATE NEGOTIATIONS HAD SUGGESTED THAT FUND NOT RETURN TO LISBON UNLESS GOP FIRST TOOK SOME FIRM, BUT UNSPECIFIED, POLICY STEPS. I AGREED TO MEET WITH HIM THE FOLLOWING MORNING. SHORTLY THEREAFTER, CONSTANCIO REACHED FUND EUROPEAN DIRECTOR WHITTOME AND PRESSED FOR RESUMPTION OF NEGOTIATIONS, STATING HE FELT FUND HAD NO LEGAL BASIS FOR REFUSING A MEMBER COUNTRY'S REQUEST FOR NEGOTIATIONS. HE NOTED ALSO THAT THE ESCUDO HAD RECENTLY BEEN FOLLOWING THE DOLLAR,
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RATHER THAN A MARKET BASKET OF CURRENCIES. AS A RESULT, IT HAS UNDERGONE AN EFFECTIVE DEPRECIATION OF 2 PERCENT SINCE EARLY MARCH. FUND THEN AGREED TO RETURN TO LISBON ON MARCH 29 TO RESUME DISCUSSIONS.

2. ECON COUNSELOR AND I MET WITH CONSTANCIO SATURDAY MORNING, MARCH 18. IN RESPONSE TO MY DIRECT QUESTION, CONSTANCIO

STATED THAT INTEREST RATE AND EXCHANGE RATE POLICIES ARE THE TWO MOST CONTENTIOUS ISSUES TO BE NEGOTIATED. HE IS PREPARED TO AUTHORIZE A FAST CRAWL DESIGNED TO ACHIEVE AVERAGE DEVALUATION TARGET RECOMMENDED BY THE FUND. HE REJECTED, HOWEVER, A SUBSTANTIAL DISCRETE DEVALUATION. SUCH A MOVE, HE MAINTAINED, WOULD IMMEDIATELY SPARK AN ACCELERATION OF THE INFLATION RATE WHICH, IN TURN, WOULD UNDERMINE THE GOVERNMENT'S WAGE POLICIES.

3. CONSTANCIO REJECTED THE FUND'S SUGGESTION FOR A SEVEN POINT INCREASE IN INTEREST RATES. HE ACKNOWLEDGED THE NEED FOR AN INCREASE, BUT STATED THAT SEVEN POINTS WOULD CAUSE SERIOUS DOMESTIC DISLOCATIONS AND NULLIFY GOP'S EFFORTS TO RESTIMULATE PRIVATE SECTOR INVESTMENT. HE INDICATED THAT, TO OFFSET SOMEWHAT THE LACK OF A SHARPER RISE IN INTEREST RATES, HE COULD ACCEPT A CREDIT CEILING APPROXIMATING WHAT THE FUND RECOMMENDED. HE EXPRESSED THE HOPE THAT NEGOTIATIONS ON THESE ISSUES WOULD BE RELATIVELY BRIEF AND AN AGREEMENT CONCLUDED RAPIDLY.

4. CONSTANCI NOTED THAT THE BALANCE OF PAYMENTS RESULTS THIS YEAR HAVE BEEN SUBSTANTIALLY BETTER THAN DURING JANUARY-MARCH 1977. FROM JANUARY 1 TO MARCH 15, 1978 BANK OF PORTUGAL'S NET FOREIGN EXCHANGE LOSSES TOTALED \$160 MILLION. THE BANK HAS OFFSET THESE LOSSES BY SELLING A SIMILAR AMOUNT OF GOLD. AS A RESULT, ITS LIQUID EXCHANGE
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HOLDINGS STILL APPROXIMATE \$300MILLION, I.E., VIRTUALLY THE SAME LEVEL AS AT THE END OF 1977.

5. SHIFTING THE FOCUS OF OUR CONVERSATION, I REMARKED THAT MY INITIAL IMPRESSIONS SUGGEST THAT PORTUGAL CANNOT SOLVE ITS EXTERNAL PROBLEMS IN THE SHORT TERM, BUT RATHER THAT IT REQUIRES A MEDIUM TO LONGER TERM PROGRAM. CONSTANCIO REAPIDLY CONCURRED. HE FIRMLY MAINTAINED THAT PORTUGAL MUST RESTRUCTURE ITS ECONOMY, PARTICULARLY ITS AGRICULTURE AND INDUSTRY. HE CLAIMED, FOR EXAMPLE, THAT PORTUGAL COULD ELIMINATE ITS LARGE NET IMPORTS OF AGRICULTURAL PRODUCTS IF IT ONLY ACHIEVED THAT PRODUCTIVITY OF GREEK AGRICULTURE. HE IS COUNTING HEAVILY ON EXTERNAL PRESSURES TO STIMULATE THESE STRUCTURAL CHANGES. THIS PERCEPTION OF THE PROBLEM EXPLAINS WHY HE PLACES SUCH GREAT IMPORTANCE ON PORTUGAL'S ENTRY INTO THE EC. HE IS COUNTING ALSO ON SUBSTANTIAL FOREIGN PRIVATE CAPITAL AND TECHNOLOGICAL COOPERATION TO PROMOTE STRUCTURAL CHANGES. WE TOOK THIS OPPORTUNITY TO MENTION OUR DESIRE TO DISCUSS WITH GOP OFFICIALS PORTUGAL'S AGRICULTURAL PROGRAM AND THE ROLE OF OUR PL-480 AND CCC CREDITS.

6. COMMENT: CONSTANCIO WAS CERTAINLY CONCERNED THAT THE
FUND WOULD NOT RETURN QUICKLY TO RESUME NEGOTIATIONS.
HE WILL UNDOUBTEDLY NEGOTIATE HARD ON INTEREST RATES, BUT
APPEARS DESIROUS OF REACHING A PROMPT COMPROMISE AGREEMENT.
WE FEEL THE RIGHT PSYCHOLOGICAL ATMOSPHERE EXISTS FOR THE
IMF'S RETURN TO LISBON TO RESUME NEGOTIATIONS.
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